



ENTERED

TAWANA C. MARSHALL, CLERK
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The following constitutes the order of the Court.

Signed October 17, 2005

Barbara J. Houser
United States Bankruptcy Judge

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION**

IN RE:

**AMERICAN ELK CONSERVATORY,
INC.,**

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CASE NO. 393-38328-BJH-11

IN RE:

CHAMA LAND & CATTLE CO., INC.,

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CASE NO. 393-38330-BJH-11

IN RE:

**AMERICAN ELK CONSERVATORY
HOLDINGS, INC.,**

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CASE NO. 393-38332-BJH-11

IN RE:

THE LODGE AT CHAMA, INC.,

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CASE NO. 393-38329-BJH-11

DEBTORS.

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§

**Substantively Consolidated
Post-confirmation**

**MEMORANDUM OPINION AND ORDER
DETERMINING TAX LIABILITY ON REMAND**

Walter O'Cheskey, the Chapter 11 trustee (the "Trustee") for four related debtors – *i.e.*, Chama Land & Cattle Co. ("Chama"), American Elk Conservatory, Inc. ("AEC"), American Elk Conservatory Holdings, Inc. ("Holdings"), and the Lodge at Chama, Inc. ("Lodge") (collectively, the "Debtors") is before the Court on remand in connection with the Trustee's First Amended Motion to Determine Tax Liability (the "Motion") filed in September 1998 and originally heard by this Court in March 1999.¹ On May 20, 2005, this Court entered its Memorandum Opinion and Order on Remand (the "May 2005 Opinion"), thereby determining the proper allocation of the Trustee's distributions to Gary² under the Plan between Gary's unliquidated damages claims and his equity interests. The May 2005 Opinion directed the parties to confer with each other and to prepare calculations determining the Trustee's tax liability in a manner consistent with the May 2005 Opinion and the previous Memorandum Opinion and Order of the District Court entered on December 21, 2001 in connection with the prior appeal (the "Opinion"). To the extent the parties could not agree on the proper calculation, the Court further directed each party to file its calculations by June 10, 2005.

After numerous extensions of the original time within which the parties were directed to submit those calculations, and several status conferences with the Court, the parties filed revised calculations on August 9 and 10, 2005. In addition, at the Court's request, the parties filed briefs on

¹The author of this Memorandum Opinion and Order became responsible for these cases (and presided over the second remand hearings) upon the retirement of the judge who was originally assigned the cases and who presided over them through the first remand hearings.

²Capitalized terms not defined herein shall have the meaning ascribed to them in the May 2005 Opinion.

August 19, 2005 explaining their remaining disputes with regard to the proper calculation of the Debtors' tax liability. After reviewing the revised calculations and briefs, the Court held further status conferences with the parties on August 24 and 26, 2005. At the conclusion of the August 26, 2005 status conference, the Court directed the preparation of further tax calculations and briefs addressing what the Trustee characterized as a "reserve" for the payment of New Mexico state income taxes. The parties filed joint revised calculations on September 2, 2005 (the "Joint Calculations") and additional letter briefs on August 31 and September 1, 2005 (by the Trustee) and September 14, 2005 (by the IRS). While the parties disagree over which of the tax calculation scenarios are legally correct, they agree that the Joint Calculations are numerically correct.

After considering all of the calculations and briefs, and in accordance with its primary ruling in the May 2005 Opinion, the Court concludes that the Trustee is entitled to a tax refund of \$1,980,081 for 1995. The starting point for this conclusion is the Court's earlier finding in the May 2005 Opinion that Gary received \$1,505,337.55 in Plan distributions in 1995 on account of his damages claims against Chama. Because the District Court has already determined in the Opinion that the Trustee (i) satisfied the tests necessary for tax deductibility as a legal matter and (ii) was entitled to certain tax benefits in 1995 due to the establishment of two Qualified Settlement Funds ("QSFs"),³ the legally correct calculation is the one which the parties have labeled as "scenario # 1"

³The IRS spends much of its August 19 brief challenging the correctness of the District Court's determination on appeal that two QSFs were established through confirmation of the Plan. Specifically, the IRS asks this Court to make its tax liability determination as if the District Court had not concluded that the Trustee was entitled to the tax benefits resulting from these QSFs. Of course, this Court is bound by the District Court's earlier decision on appeal and does not have authority to address this issue on remand. *Tollett v. City of Kemah*, 285 F.3d 357, 363 (5th Cir. 2002) (stating that the law of the case doctrine precludes a trial court, on remand, from reexamining an issue of law or fact decided on appeal); see also *Ward v. Santa Fe Indep. School Dist.*, 393 F.3d 599, 605 (5th Cir. 2004). Similarly, the "mandate rule" prevents this Court from disregarding the District Court's mandate. *Tollett*, 285 F.3d at 364 (stating that a lower court on remand must implement both the letter and spirit of the appellate court's mandate and may not deviate therefrom).

in the Joint Calculations, which consists of a \$1,505,337.55 deduction for damages paid to Gary and a QSF deduction.

Alternatively, and in accordance with this Court's alternative ruling in the May 2005 Opinion, the Court concludes that the Trustee is entitled to a tax refund of \$1,508,564 for 1995. The starting point for this alternative conclusion is the Court's alternative finding in the May 2005 Opinion that Gary received \$716,555.55 in Plan distributions in 1995 on account of his damages claims against Chama. Again, because the District Court has already determined in the Opinion that the Trustee (i) satisfied the tests necessary for tax deductibility as a legal matter and (ii) was entitled to certain tax benefits in 1995 due to the establishment of two Qualified Settlement Funds ("QSFs"), the legally correct calculation to support this alternative ruling is the one which the parties have labeled as "scenario # 2" in the Joint Calculations, which consists of a \$716,556 deduction for damages paid to Gary and a QSF deduction.

The only other variable raised by the Trustee in calculating the Debtors' tax liability for 1995 is the deductibility of certain additional New Mexico state income taxes, the liability for which will flow from the finally determined federal tax liability. In short, the Trustee asserts that the Debtors are entitled to a deduction from the Debtors' 1995 federal taxable income for the additional, but as yet unpaid, New Mexico state income taxes. The IRS contests the deductibility of the unpaid state income taxes from the Debtors' 1995 federal taxable income.

For the reasons explained briefly below, the Court concludes that the Debtors are not entitled to a deduction for these unpaid New Mexico state income taxes. In short, the full amount of the New Mexico state tax liability was not fixed in 1995 under the so-called "all events" test because the amount of the liability could not be determined with reasonable accuracy. The state tax liability could

not be fixed at that time because it piggybacks the underlying federal tax liability which was contested by the Trustee (and still remains in dispute). When the federal tax liabilities are finally adjudicated, the amount of the New Mexico state income taxes can be determined and the Debtors will be entitled to a deduction in that year. This conclusion is consistent with the holding in *Consolidated Industries, Inc. v. Commissioner*, 767 F.2d 41 (2nd Cir. 1985).

While the Trustee initially attempted to distinguish the *Consolidated Industries* decision, the focus of the Trustee's final letter briefs is on two arguments. First, the Trustee contends that a 26 U.S.C. § 461(f) fund (the "Section 461 Fund") was established for the payment of New Mexico state income taxes and that the "monies were actually deposited and held in the Court and only allowed out of the Court when the [IRS] had given a figure for the payment of *all* taxes claimed." See August 31, 2005 letter from Bruce Bowman at p. 2 (emphasis in original). Second, the Trustee contends that the IRS should be estopped from challenging the deductibility of the unpaid New Mexico state income taxes because the IRS "originally allowed an accrual of the New Mexico income taxes even though all taxes had not been paid." *Id.* The Trustee attached certain documents to his August 31 and September 1, 2005 letter briefs to support his latest arguments.

The IRS disputes the Trustee's characterization of these documents – both legally and factually. See September 14 letter from Waymon DuBose. While the IRS admits that it "did mistakenly allow a deduction for New Mexico state income taxes that had not been paid" in calculating the amount to be paid by the Trustee pending appeal in 2000, it also points out that this Court previously held in connection with the first remand that the IRS was not estopped by such mistake from calculating the correct amount due by the Trustee. *Id.*

To prevail on his estoppel argument against the IRS, the Trustee must demonstrate: "1) a

misrepresentation by an agent of the United States acting within the apparent scope of his duties; 2) absence of contrary knowledge by the taxpayer; 3) reliance by the taxpayer; 4) detriment to the taxpayer; and 5) facts such that absence of equitable relief would be unconscionable.” *L.R. Hollenbeck, D.D.S. v. United States Internal Revenue Service (In re L.R. Hollenbeck, D.D.S.)*, 166 B.R. 291, 295 (Bankr. S.D. Tex. 1993). These elements evince a greater burden on the Trustee than that necessary for an ordinary estoppel argument made against a non-governmental entity. The rationale behind the increased burden is that “[w]hen the government is unable to enforce the law because the conduct of its agents has given rise to an estoppel, the interest of the citizenry as a whole in obedience to the rule of law is undermined.” *Id.*

The United States Supreme Court has held that a claimant cannot estop the government from contesting a payment to that claimant where the payment would be made in contravention of federal law, reasoning that such an estoppel would force the government to take action that runs afoul of the Appropriations Clause of the Constitution. *See Office of Personnel Management v. Richmond*, 496 U.S. 414, 424-26 (1990) (holding that government was not estopped from denying benefits not permitted by statute to federal benefits claimant who received erroneous advice from government employee leading claimant to believe he was entitled to benefits). Citing the reasoning of the Supreme Court in *Richmond*, the court in *Southwestern States Marketing Corp. v. Kellogg*, 179 B.R. 813, 817 (N.D. Tex. 1994) held that the IRS could not be estopped from contesting a trustee’s tax deduction and corresponding refund claim. The court reasoned that the IRS’ issuance of an “accepted as filed” letter in response to the trustee’s submission of Form 1120 did not estop the IRS from later challenging the merits of the trustee’s claimed deduction, because to do so would “require payment in violation of 26 U.S.C. §§ 461(h)(4) and 446(b).” *Id.* at 816-17.

On the limited record before the Court – *i.e.*, the documents attached to the Trustee’s final letter briefs, the Court concludes that the Trustee has failed to establish the existence of a Section 461 Fund. Moreover, the Trustee has failed to prove conduct by the IRS sufficient to estop it from contesting the deductibility of the unpaid New Mexico state income taxes at issue here.

For these reasons, the Trustee is not entitled to deduct unpaid New Mexico state income taxes from the Debtors’ 1995 federal taxable income.⁴ Accordingly, the Trustee is entitled to a refund for 1995 of \$1,980,081. Alternatively, the Trustee is entitled to a refund for 1995 of \$1,508,564.

Upon the entry of this Memorandum Opinion and Order on Remand, the Court has fully disposed of the issues remanded to it by Order of the District Court dated September 13, 2004.

SO ORDERED.

End of Order

⁴ Scenarios 1 and 2 of the Joint Calculations do not include a deduction for the unpaid New Mexico state income taxes. Rather, that deduction was included in the calculations set forth in scenarios 3 and 4 of the Joint Calculations.